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Louisa Menchaca  
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Fair Political Practices Commission  
P.O. Box 807  
428 J. Street  
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RE: Advice Letter No. A-01-064

Dear Ms. Menchaca:

I have been retained by Colin J. Coffey of the Archer-Norris law firm to assist them in their representation of the Peninsula Health Care District. In that capacity, I have been asked to review and analyze the above referenced Advice Letter and to communicate to your office the results of my analysis. Since I believe the advice should be revised, my clients have asked me to request your reconsideration of the advice and the issuance of a new and different letter.

In summary, the staff advised that Director Hanko received "commission income" from her employer in the form of her incentive bonus. The staff further advised that despite the fact that Director Hanko had no right to receive the income and her employer's customers had no control over whether or how much of a bonus she might receive, the customers should be considered a "source" of the incentive bonus.

In my opinion, the staff's conclusion is erroneous. Neither the statute nor the regulation supports the staff conclusion. Staff reliance upon old advice letters is misplaced. Finally, the staff gave little or no weight to the significant differences between the facts in this matter and the key facts in the prior advice letters on which they relied. Taken individually and together, these considerations should persuade you to change the advice given to the District and we ask you to do so at your earliest opportunity.

The Statute

The Political Reform Act, as amended, does not define the "source of income" with respect to disqualifying conflicts of interests of public officials. Government Code section 87103 defines "financial interest" for purposes of disqualification. Section 87103(c) simply refers to "[a]ny source of

income..." without defining the term and without reference to commissions, sales persons or any source other than the actual payor. The only definition of "source of income" is found in the regulations.

### Regulation 18703.3

Regulation 18703.3 seeks to clarify, for purposes of conflict of interest analysis, the identity of various "sources of income." Normally, the source of income is the one who makes the payment. Subsection (a) of Regulation 18703 states: "A public official has an economic interest in any person from whom he/she has received income aggregating two hundred fifty dollars (\$250) within 12 months prior to the time when the relevant governmental decision is made." The actual payor is the "source of income" unless some other regulation creates an exception to this general rule.

The only regulation which varies the general rule for "commission income" is Regulation 18703.3(c). Thus, unless subsection (c) creates an exception, the general rule embodied in subsection (a) would apply to make the actual payor the source of income. Subsection (c) governs the identification of the source of "commission income." The Commission tried to fashion a regulation that was narrow and targeted to the specific situations it chose to regulate. There is no suggestion in the rule making file of any intent to go beyond the obviously limited scope of the regulation. The regulation states in relevant part:

- (c) Sources of Commission Income to Brokers, Agents and Salespersons
- (1) This subsection contains the disclosure and disqualification requirements for *any public official who receives commission income* for services rendered as an insurance broker or agent, a real estate broker or agent, a travel agent or salesperson, a stockbroker or a retail or wholesale salesperson.
- (2) "Commission income" means gross payments received as a result of services rendered as a broker, agent, or other salesperson *for a specific sale or similar transaction*. Commission income is received when it is paid or credited. (Emphasis added.)

The regulation clearly intends to identify the source of income "for any public official who receives commission income." In the *Hanko Advice Letter*, the staff concluded that the incentive bonus received by Director Hanko was a "commission." Thus, the identification of Director Hanko's sources of "commission income" is governed by the regulation. It is clear that the Commission intended for commission income to be attributable to a source other than the actual payee, only where it comes from a "*specific sale or similar transaction*." In her case, Director Hanko does not receive any incentive bonus from a "specific sale or similar transaction." Accordingly, subsection (c) will not operate to make anyone other than the actual payor, the "source of income" to Director Hanko.

The Commission recognized that unless there is a specific sale, the connection between the public official and some "source" other than the actual payor, becomes too speculative and attenuated to justify disqualification. Accordingly, payments which are generated not from specific sales, but rather, from general territorial sales are not within the regulation. If these payments are not covered by subsection (c) then they are governed by the general rule of subsection (a) which identifies the actual payor as the source.

If the Commission had wanted to expand the scope of the regulation beyond the commission income generated from specific sales, they certainly could have done so when the regulation was created in 1984, or when the regulation was reconsidered and renumbered in 1998 and again when it was amended in 1999. Significantly, the two advice letters on which the staff relies, were written *before* the regulation was renumbered and amended in the late 1990's. Therefore the Commission could have incorporated the interpretation of the *Larson and Anaforian*<sup>1</sup> into the regulation if they wished, but did not.

The staff was partially correct when they concluded in the *Hanko Advice Letter* that, "Consequently, Regulation 18703.3 does not control where a bonus is provided based on the volume of sales as contrasted with a payment received as a commission for a "specific sale or similar transaction." What they failed to note was that if subsection (c) was not controlling, then *subsection (a) is controlling.*

Since Regulation 18703.3(a) identifies the actual payor as the source of income, the staff has no authority to change this result by giving contrary advice. Prior staff advice is not legal authority nor is it superior to the regulation. Where such advice is contrary to the statute and the only regulation dealing with the subject matter, it cannot be authority for the current advice letter. It appears that the staff concluded that MPHS *ought* to be considered the source of Director Hanko's income, and finding no other basis for their conclusion, they relied upon the *Larson* and *Anaforian* Advice Letters, *supra*, which are themselves inconsistent with the regulation.

It is impossible to justify a result which is inconsistent with the statute and the only regulation on the subject. Since application of the statute and the regulation fails to attribute "commission income" to anyone other than the actual payor, that should be the end of it. Neither the drafters of the PRA and its many amendments, nor the legislature, nor the Commission itself has seen fit to expand the scope of the regulation and the statute to deem entities like MPHS as sources of income. Therefore, the staff should not attempt to create new law in the guise of interpreting the Act.

The advice is even more precarious if examined from another perspective. If Director Hanko were to ignore staff advice and participate in decisions affecting MPHS, she could not be prosecuted. She could hardly be charged with violating Government Code sections 87100 and 87103, because MPHS is not a source of income under the statute. She would also not be in violation of the regulation because staff has already concluded that subsection (c) of regulation does not apply to her and subsection (a) makes the payor the source. It is not a violation of the Act to disagree with staff advice.

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<sup>1</sup> Larson Advice Letter (No. I-89-555); Anaforian Advice Letter (No. I-90-312)

### Prior Advice Letters

I believe the *Larson* and *Anaforian* Advice Letters were wrong when they were issued, and over time they have become even more anachronistic. However, even if one were to accept these letters as good authority, the current staff advice given to Director Hanks does not follow the reasoning in these letters, but extends it beyond the bounds of reason.

The staff analysis of these prior advice letters is telling. In *Larson*, the staff advised that a County Supervisor's spouse, who was compensated by a fixed salary, coupled with bonuses based on the volume of agricultural processing done at the employer's plant, must treat the farmers whose products were processed as sources of income. In the *Hanks* letter, the staff explains, "This conclusion was based on the fact that the bonuses were *akin* to commission payments."

In explaining the *Anaforian* advice, the public official was a sales representative for a pharmaceutical company who earned bonus income based upon the volume of his company's products sold. The staff concluded that the sources of income to the public official included the clients of the company, not just the company which paid the bonus income. In *Hanks*, the staff explains this result by stating, "Based on the reasoning employed in the *Larson* letter, we concluded that the bonus was *analogous* to a commission and, therefore, the company's clients serviced by the council member were a source of income."

The problem with both the *Larson* and the *Anaforian* letters is that a person is not a "source of income" just because the payment is "akin" to or "analogous" to a commission. One is not required to report things "like" sources of income. If a source of commission income is reportable or disqualifying, it can only be so because the statute, as reasonably interpreted by the regulations, requires it. Neither the law nor the regulations requires such a result here, and the staff advice is contrary to both law and regulation. It is not the role of staff advice to create the law, but to interpret it. Here, the staff has sought to create a rule of its own making to fill some perceived gap in the statute and regulations. That is a role for the legislature or for the Commission in its rule making function, but not for staff advice.

The facts in the *Hanks* situation are also materially different from those present in *Larson* and *Anaforian*. In both *Larson* and *Anaforian*, the bonus payments were automatic. In *Larson*, the staff based its advice, in part, on the fact that, "the bonus payments are not discretionary, but are, in a sense, owed to the spouse." The letter went on to state, "Thus, the automatic bonus which is 'owed' to the spouse for the volume of production is similar to the commission arrangement discussed in *Carey*." The *Larson* letter then concludes, "We conclude, therefore, that the farmers in question have sufficient control over the income received by the spouse to constitute sources of income to him."

It appears that the staff considered the automatic, non-discretionary nature of the bonus income, coupled with the "control" which the customers could exert over the receipt of bonuses to make these payments enough "like" commissions to deem the customers to be the sources of income. Whatever one thinks of the "regulation by analogy" inherent in the *Larson* analysis, these factors are not present in Director Hanks's situation.

In the *Anaforian* letter, the staff adopted the same analysis, quoting from Larson as follows:

The bonus payment is made to the spouse automatically, as in the case of a real estate commission automatically paid to an agent. Thus, the automatic bonus which is "owed" to the spouse for the volume of production is similar to the commission arrangement discussed in Carey. "[T]hese farmers appear to have control over whether or not the spouse receives the bonus income attributable to their produce.

In the Hanco situation the bonuses are not "automatic," nor are they "owed" to Director Hanco, nor do the customers have any "control" over whether or how much of a bonus Director Hanco may receive. The bonus incentive plan adopted by Director Hanco's employer states:

1. Baxter reserves the right to modify, interpret, or cancel the program described in this document or any of its provisions at any time for any reason. This document creates no explicit or implied contract between Baxter Healthcare Corporation and the employee. It has been prepared for Company purposes and for the use of Company employees only.
2. Due to changing market conditions, Management also reserves the right to change budgets and or other measures of sales performance..... These policies and related procedures may be changed at any time at Management's discretion.

Thus, the most important analytical underpinnings of the *Larson* and *Anaforian* advice letters are absent here. There is no "debt," no "obligation," nor is the payment or amount of the bonus "automatic." The clients and customers of the employer have no "control" over the fact or amount of any of Director Hanco's bonus payments. The employer alone determines whether and how much of an incentive bonus Director Hanco may receive.

Further, while Director Hanco may receive a bonus if sales of products in her area exceed a certain target amount, there are many factors which may lead to increases or decreases of sales. For example, general healthcare economic trends, trends in the demographics of her area, the relative success of particular products and medical utilization of a product may affect total sales volume in Director Hanco's area. The clients and customers of Baxter simply do not have "control" over whether and how much of a bonus Director Hanco receives. Accordingly, since the reasons for the conclusions in *Larson* and *Anaforian* are not present in the Hanco situation, these prior advice letters provide no support for the staff advice given to the District.

The staff has determined the "control" issue to be important or determinative in other situations as well. For example, when considering whether a public official has a financial interest in an irrevocable trust, where the trustee has the power to invade the principal for the benefit of someone other than the public official, the staff advised that, "...the official might not receive his or her share of the trust principal or income due to events beyond his or her control. Thus, the official's interest in the trust is too speculative to require disqualification." (*Boitano Advice Letter* No. A-97-557(a).) The same is true

with Director Hanko. Whether or how much of a bonus Director Hanko receives is beyond her control and it is too speculative to require disqualification from decisions which might affect customers of her employer who are not her direct payors.

In the *Kuperberg Advice Letter*, No. A-99-232, staff analyzed whether a former spouse's employer would be considered the source of alimony payments. The staff advised:

The alimony payments received by the mayor most likely derive from her former spouse's salary from Tosco. Generally, the person who controls a payment made to an official is considered to be the source of that income [citations omitted]. Tosco has no control over alimony payments made by Mayor Shea's former spouse. Moreover, the term "income" excludes alimony. (Section 82030(b)(7).) As such, the mayor does not have an economic interest in Tosco as a source of income.

Obviously, the staff in *Kuperberg, supra*, believed that the statute was not reason enough to conclude Tosco was not a source of income. The staff identified Tosco's lack of "control" to be an essential part of the analysis leading to the conclusion that Tosco was not a source of income. The staff advised that, "Generally, the person who controls a payment made to an official is considered to be the source of that income." In the Hanko situation, only the employer had control of the payments.

In a situation where the staff was asked to advise whether the Los Angeles Turf Club or the individual wagerers were the sources of income to horse owners who won purses at Santa Anita, the staff gave the following advice as relevant to the Hanko situation:

Despite the fact that the funds the Turf Club distributes come from the money bet by members of the public who attend the racing event at Santa Anita Park and at off-track betting facilities, the Turf Club is the corporate entity that is the source of income to Mr. Roncelli. . . . ¶ Under the Act, we do not "look through" the corporation to find that the thousands of individuals who place bets on the races at Santa Anita are sources of income to the council member. . . . ¶ Generally, the Act considers clients, customers, or other sources of income to a business to be sources of income to a public official when the official owns a ten percent or greater interest in the business. . . . In addition, the Commission has in *rare circumstances* "pierced" through entities, such as corporations, which are the apparent source of income, to treat the *controlling person* as an additional source of income or economic interest of the official's. [Citations omitted.] In this situation, however, the thousands of individuals who bet on the horse races do not have any ownership or controlling interest in the Los Angeles Turf Club. They do not direct or control the income to council member Roncelli. They are not the "true" or "additional" source of income to council member Roncelli whom we should look through the Los Angeles turf Club corporation to reach. [Emphasis added.] (*Miller Advice Letter*, No. A-99-019.)

Further, as staff pointed out in the *Dorsey Advice Letter*, No. I-00-176:

Every source of income has its own source of income and, since the Act does not define "source" (as it defines "income"), it has been necessary to impose some limiting principle on the term "source of income," to prevent its expansion beyond reasonable boundaries. The purposes of the Act are usually well served by limitation of the term to the parties bound under an agreement that provides for the official's payments.

It appears to us that the staff advice to the District was just the kind of "expansion beyond reasonable boundaries" that the staff warned about in the *Dorsey Advice Letter*. Moreover, the staff clearly ignores the pivotal nature of "control" in the Hanko situation. Numerous prior advice letters, including the letters staff claim to rely upon here, posit control as perhaps the most important element in the analysis. Yet in the *Hanko Advice Letter*, staff dismisses the control issue as unimportant.

The staff shrugs off the significant factual differences between Director Hanko's situation and those found in *Larson* and *Anaforian*. The staff ignores the key bases for the conclusions reached in *Larson* and *Anaforian*. The staff simply states that the absence of these key elements does not matter, although they do not say why. Nor does the staff offer any alternative analytical structure for their conclusion.

The staff also has not given thought to the impact of the extension of the "per transaction" commission analysis to "incentive bonus" arrangements lying outside the scope of Regulation 18703.3. Public officials who potentially receive some form of year-end bonus based on aggregate company productivity now have the prospect of unanticipated conflicts. Given the difficulty Director Hanko will encounter trying to predict whether the incentive bonus system used by Baxter will create a "source of income" connection to MPHS for her (subject to the whims of Baxter in implementing its bonus program), other office holders similarly situated could easily be caught off guard. If in one year the bonus was not awarded, they can suddenly find themselves in the next year subject to conflicts limitations if a bonus is awarded. The conflict can be caused by bonuses based on aggregate employer productivity involving sales to employer clients not even connected to the activities of the office holder/employee.

Moreover, staff suggests that the mere fact that a bonus program is "in effect" gives rise to the application of the conflict prohibitions. But will that application of conflicts rules apply only at that point in time when the employer's aggregate sales exceed company bonus triggers (even if the company reserves the right to not award a bonus)? Will it apply retroactively once the company has determined to award the bonus based on the past year's performance? Or will it apply only prospectively once the company makes the decision to award the bonus? The foregoing serves to suggest that the "distinction without a difference" relied upon by staff actually causes great uncertainty and difficulty in application of conflicts prohibitions where the award of a bonus is not "per transaction" and not automatic.

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### Severe Impact of Staff Advice

While the staff advice to the District lacks reason or authority, its impact upon the District's decision making process will be profound. That is because most of the business conducted by the District in recent years involves decisions impacting the District's relationship with MPHS, both as Landlord and as a healthcare agency interested in the provision of health services to the communities served by the District. The advice therefore necessarily impacts a majority of decisions of consequence coming before Director Hanko and the remaining Board. This agency's existence revolves around the operations of MPHS. The staff's advice is therefore unique in that its impact is on the essence of the job voters elect members of the District's Board to do — as opposed to a transitory issue of singular importance in the life of the agency.

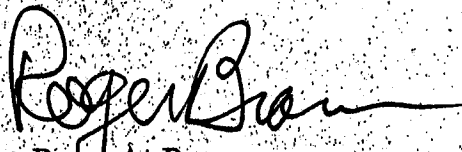
### Conclusion

The staff advice could not withstand the scrutiny of a legal challenge as it seeks to impose the result without reason or authority to support it. The advice ignores important aspects of prior advice and its reasoning conflicts with prior advice. Director Hanko could not be prosecuted for acting contrary to the staff advice because her conduct would not violate the statute or the regulation.

Director Hanko should not be forced to risk an enforcement action or a lawsuit to test the staff advice. Since the staff advice is clearly erroneous, it should be revised and supplanted with a new and different advice letter. The staff should conclude that Director Hanko has no financial interest in MPHS within the meaning of Government Code section 87103 and that MPHS is not a source of commission income to her. As a result, Director Hanko should be advised that she has no disqualifying conflict of interest in decisions affecting MPHS as a result of her receipt of incentive bonus income.

We appreciate your willingness to reconsider the staff advice previously provided to Director Hanko and look forward to your favorable response.

Very truly yours,



Roger A. Brown

RAB: hs

cc: Colin Coffey, Archer Norris